STATE OF CALIFORNIA Arnold Schwarzenegger, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
OFFICE OF THE DIRECTOR
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January 4, 2010

Puneet K. Sandhu
Munger, Tolles & Olson
355 South Grand Avenue, 35th Floor
Los Angeles, CA 90071

Re: Request Of Exception Under Labor Code § 1402.5 (Cal-Warn Act)
Employer: Insync Marketing Solutions, LLC

Dear Ms. Sandhu:

This matter arises from written requests in July, 2009 submitted both to the Division of Labor Standards Enforcement (Division) and the Director of the Department of Industrial Relations for a determination that Insync Marketing Solutions, LLC's (Insync) was not required to give the requisite employee notice under the California WARN Act when it closed its California facility in Los Angeles County on February 20, 2009, resulting in the termination of approximately 230 workers. Insync seeks the exemption on the basis that it fulfills the requirements under Labor Code Section § 1402.5[1] for an employer actively seeking capital or business at the time notice would have been required.

The Director referred the submissions of Insync to California Labor Commissioner Angela Bradstreet for review. Based upon a review of the facts of this case and the applicable law, the Director adopts the findings of the Labor Commissioner, as incorporated herein, and determines that Insync does not meet the requirements of Section 1402.5 and therefore is not excused from providing its affected employees with the 60-day notice required by Section 1401(a).

I. FACTUAL BACKGROUND

A. The Request for Determination

On or about July 13, 2009, the Division received your letters dated July 8, 2009, and July 9, 2009. The July letters enclosed a May 28, 2009, letter from Munger, Tolles & Olson attorney Manuel F. Cachan, to the Employment Development Department (EDD), and explained that Cachan originally submitted the application for a determination under Section 1402.5 to the EDD, but had since learned that the application needed to be made to the Department of Industrial Relations (DIR).

In the May 28, 2009, letter, Cachan indicates that his firm does not represent Insync but a substantial investor in Insync, Nogales Investors Fund I, LP (Nogales Fund). Cachan also informs

[1] All statutory section references are to the California Labor Code unless otherwise indicated.

that Insync filed for bankruptcy under Chapter 7 of the United States Bankruptcy Code on February 25, 2009, five days after closing its doors on February 20, 2009.[2]

B. Evidence Submitted in Support of Request for Determination

In support of its request, Nogales Fund submitted declarations from Jesse Macias, former Chief Financial Officer of Insync, Thomas Murphy, Managing Director of M&A Capital, Inc., an investment banking firm hired by Insync, and Mark Mickelson, a partner in Nogales Investors Management, LLC. Attached to Mickelson's declaration, Nogales Fund also submitted correspondence, income statements, PowerPoint presentations, term sheets, and other documents in support of its contention that Insync is entitled to the exception under Section 1402.5 to California Warn notification requirements.

According to documents and information submitted, Insync was a commercial printing company that employed 230 workers at a facility in Los Angeles County, and additional workers at a facility in Michigan, prior to ceasing operations on February 20, 2009. (*See* Macias' Declaration, ¶¶ 5, 6.) In at least May of 2008, Insync faced serious financial difficulties and concluded that additional capital was needed for the company. Insync hired an investment banker, Thomas Murphy, to obtain refinancing to replace or supplement funds provided by Insync's major creditor, Wells Fargo Bank, or find a buyer. (*See* Macias Declaration, ¶ 10; Murphy Declaration, ¶ 4.) By January 2009, it was apparent that Insync needed to be immediately sold or needed an infusion of significant capital if it was to continue operations. (*See* Macias Declaration, ¶ 12.) Also, in January, Wells Fargo informed Insync that it would continue funding the company to give Murphy and his company a chance to find a buyer. (*See* Macias Declaration, ¶ 12.). Nogales Fund submitted evidence in support of its contention that in early 2009, Insync's management reasonably believed that an investor or purchaser would be found and the company could continue operations. (*See* Macias Declaration, ¶ 12.) None of these potential investors or buyers is named nor are any specific dates identified.

Murphy provides in his declaration the details of his company's efforts to find a potential buyer or investor. It appears that Murphy's role was limited to scanning financial documents, in conjunction with Insync's management, to compile an electronic file that would enable 100 or so invited potential buyers or investors to view the data and conduct its own due diligence examination. Murphy estimates that ten percent of the invited buyers or investors accepted the invitation to view the electronic data. Murphy, without providing any dates, states that his company received tentative offers from a few banks to lend Insync money. Murphy states, however, that by the time notice would have been required under California's Warn requirements, Insync had exhausted its line of credit with its bank and efforts were based upon finding a buyer. According to Murphy:

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[2] Cachan contends in his May 28, 2009, letter that Insync, not Nogales Fund, was the employer of Insync's employees for California Warn Act purposes, and Nogales Fund contends that it faces no liability under California Warn, but submits the request for a determination out of an abundance of caution. Under Labor Code § 1400(b), "employer" is defined as "any person, as defined by Section 18, who directly or indirectly owns and operates a covered establishment."

> [W]ell before the time that WARN Act notices would presumably have been required—that is, 60 days before the February 20, 2009 terminations—Insync had already exhausted its line of credit. Its day-to-day expenses (including payroll) were being funded by Wells Fargo, but only because Wells Fargo thought there was a reasonable chance Insync could be sold for some amount sufficient to cover Insync's debt.

(*See* Murphy Declaration, ¶ 12.)

Nogales Fund submitted evidence contending that Insync reasonably believed giving notice would have precluded the Insync from obtaining the needed capital or business because Insync believed it would lose good sales employees, that customers would take their business elsewhere, and that the announcement of layoffs and associated instability would have made likely investor and purchasers unwilling to take the risk of investing in Insync. (*See* Macias Declaration, ¶ 13.) This would lead to investors being unwilling to invest in the company, much less purchase it, and cause Wells Fargo to immediately withdraw funding. (*See* Murphy Declaration, ¶ 13.)

In mid-February, 2009, Murphy's company, M & A Capital, informed Insync that there were no longer any buyers or potential buyers for the company and Wells Fargo immediately informed Insync that it would cease lending Insync funds for its operations, including payroll payments. Without such funds, Insync was unable to continue operating and ceased operations on February 20, 2009, terminating all of its employees. (*See* Macias Declaration, ¶¶ 14, 15.)

II. THE ACTIVELY SEEKING CAPITAL OR BUSINESS EXCEPTION UNDER SECTION 1402.5

Section 1402.5 sets forth an exception to the employee notification requirement and provides in full:

(a) An employer is not required to comply with the notice requirement contained in subdivision (a) of Section 1401 if the department determines that all of the following conditions exists:

(1) As of the time that notice would have been required, the employer was actively seeking capital or business.

(2) The capital or business sought, if obtained, would have enabled the employer to avoid or postpone the relocation or termination.

(3) The employer reasonably and in good faith believed that giving the notice required by subdivision (a) of Section 1401 would have precluded the employer from obtaining the needed capital or business.

(b) The department may not determine that the employer was actively seeking capital or business under subdivision (a) unless the employer provides the department with both of the following:

(1) A written record consisting of all documents relevant to the determination of whether the employer was actively seeking capital or business, as specified by the department.

(2) An affidavit verifying the contents of the documents contained in the record.

(c) The affidavit provided to the department pursuant to paragraph (2) of subdivision (b) shall contain a declaration signed under penalty of perjury stating that the affidavit and the contents of the documents contained in the record submitted pursuant to paragraph (1) of subdivision (b) are true and correct.

A. Actively Seeking Capital Or Business

Section 1402.5(a)(1) requires that the employer must have been actively seeking capital or business as of the time notice "would have been required," which is at least 60 days prior to the effective date of any mass layoff, relocation, or termination. (Labor Code § 1401(a).) Here, Insync closed its doors and terminated the affected employees on February 20, 2009. Thus, under Section 1401(a), Insync must have been actively seeking capital or business on about December 22, 2008, which is 60 days prior to the date the termination order took effect.

Insync presents no facts indicating that Insync was "actively seeking capital or business" at the relevant time. Rather, the evidence presented in the documents and declarations submitted indicates that at least as of December 22, 2008, the only option being considered by Insync was a sale of the business, not the investment of additional capital. (*See* Murphy Declaration at ¶¶ 12 and 13.)

There are no identified published cases interpreting Section 1402.5. Section 1402.5 is modeled in substantial part, however, upon the "faltering company" exception set forth in the federal Warn Act, which provides:

> An employer may order the shutdown of a single site of employment before the conclusion of the 60-day period if as of the time that notice would have been required the employer was actively seeking capital or business which, if obtained, would have enabled the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business.

(*See* 29 U.S.C. § 2102(b)(1).) When California laws are patterned after federal statutes, federal decisions interpreting the federal provisions are persuasive authority. (*See Alcala v. Western Ag Enterprises* (1986) 182 Cal. App. 3d 546, 550.) Regulations promulgated by the federal Department of Labor to interpret and implement the federal Warn Act provide that an employer seeking to qualify for the faltering company exception must demonstrate that the following four conditions are satisfied:

(1) the employer was actively seeking capital or business at the time the notice would have been required;

(2) there was a realistic opportunity to obtain the financing or business sought;

(3) the financing or business sought would have been sufficient, if obtained, to keep the business open for a reasonable period of time; and

(4) the employer reasonably and in good faith believed that giving the required notice would have precluded the employer from obtaining the needed capital or business.

(*See* 20 C.F.R. § 639.9(a).) These federal regulations make clear that the sale of a business does not constitute "actively seeking capital or business." 20 C.F.R. § 639.9 provides at subsection (a)(1) that "the employer must have been seeking financing or refinancing through the arrangement of loans, the issuance of stocks, bonds, or other methods of internally generated financing; or the employer must have been seeking additional money, credit, or business through any other commercially reasonable method. The employer must be able to identify specific actions taken to obtain capital or business."

Several courts interpreting the federal Warn Act requirements have concluded that the federal faltering company exception does not apply to the sale of a business as a matter of law.[3] In *Local 397, International Union of Electronic, Electrical, Salaried Machine and Furniture Workers v Midwest Fasteners, Inc.* (D. N.J. 1990) 763 F. Supp. 78, the manufacturer of welding fasteners and equipment sought to invoke the federal faltering company exception as it was attempting to find a purchaser for the business after efforts to secure new financing failed. The court analyzed the defendant employer's efforts and determined that at the time notice was required to be given, the employer had ceased all efforts to secure new financing and was attempting only to find a purchaser. The court held that the employer's coordinating of a sale of the facility did not qualify as "actively seeking capital or business," stating:

> If Congress intended a sale to fall within [the faltering company] exception, it would have expressed such an intent. Instead, Congress restricted what it specifically referred to as a "narrow" exception to the activities of seeking capital, such as obtaining loans, issuing bonds or stock, or the activity of securing new business.

(*See Local 397, supra,* 763 F. Supp. at 83.) The court also cited to legislative history in support of its conclusion that Congress did not intend the narrow faltering company exception to apply to the sale of a plant:

> In the Act itself, Congress specifically addressed the allocation of the burden of providing notice when a sale of the business occurs. 29

[3] California law does not provide any state counterpart to the "unforeseeable business circumstances" exception or the "natural disaster" exception set forth in 29 U.S.C. §§ 2102(b)(2)(A) & (B) and 29 CFR §§ 639.9(b) & (c).

> U.S.C. § 2101(b)(1). This compels the conclusion that Congress did not overlook the possibility that a sale might affect a plant closing.

(*See id.*)

In *United Paperworkers International Union v. Alden Corrugated Container Corporation* (D. Mass. 1995) 901 F. Supp. 426, defendant manufacturers contested their liability under the federal Warn Act on numerous grounds, including the faltering company exception. There, after enduring extremely difficult market conditions and reorganization efforts, the employer's bank called its loan to the employer but agreed to allow the employer to continue its operation on a week-to-week basis to afford the employer the opportunity to find a purchaser for its business. Although the employer located an interested buyer, that prospective buyer advised the employer that its bank would not finance the acquisition. When the employer's bank learned of this development, the bank ordered the employer to close down nearly immediately. Citing the legislative history for the faltering company exception, the court held that at the time notice was required to be given, there was no evidence presented that the employer was seeking new business. (*See United Paperworkers, supra,* 901 F. Supp. at 441.) Citing *Local 397, supra*, the court also concluded that the details presented about the sale were insufficient to support a finding that the employer had carried its burden to demonstrate the applicability of the faltering company exception. (*See id.*, at 441-442.)

In *Law v. American Capital Strategies, Ltd.*, No. 3:05-0836, 2007 WL 221671, at *10 (M.D. Tenn. 2007), the court similarly concluded that the federal faltering company exception was not applicable where the closing occurred as a result of the failed sale of the business. In so holding, the court stated:

> The language of the statute and the regulations promulgated pursuant thereto speak in terms of the employer seeking capital or business which would allow the employer to avoid a shutdown, not a sale of the company which would allow another entity to the run the company.

(*See Law, supra,* 2007 WL 221671, at *10; s*ee also, Wallace v. Detroit Coke Corp.*, (E.D. Mich. 1993) 818 F. Supp. 192, 197-198 ["Here, rather than keeping the plant afloat, Crane tried to sell it—an option not covered under the exception."].)

The documents and information presented by Insync do not support the conclusion that it was, at the time notice would have been required, "actively seeking capital or business" within the express terms of Section 1402.5(a)(1). Nor would Insync's conduct in seeking a buyer satisfy the faltering company exception under the federal Warn Act requirements, upon which the exception under Section 1402.5 is based. Accordingly, the requirements under Section 1402.5(a)(1) are not met here.

B. <u>Capital Or Business Sought Must Have Enabled Employer To Avoid Or Postpone Termination</u>

Section 1402.5(a)(2) requires that the employer must show that the capital or business sought, if obtained, would have enabled the employer to avoid or postpone the relocation or termination. Again, from the record supplied and relied upon, the only option being pursued was a sale of Insync, not additional capital or business. Accordingly, Insync presents no facts indicating that Insync was "actively seeking capital or business" within the express, plain meaning of Section 1402.5(a)(1).

In addition, like the first prong of the analysis, the federal regulations do not support an exception to notice. The federal regulations provide that "The employer must be able to objectively demonstrate that the amount of capital or the volume of new business sought would have enabled the employer to keep the facility, operating unit, or site open for a reasonable period of time." (*See* 20 C.F.R. § 639.9(a)(3).) Here, Insync has failed to meet this condition because the only option being considered at the requisite time was a sale of the business itself.

C. Reasonable And Good Faith Belief That Giving Notice Would Preclude Employer From Obtaining Capital Or Business

Finally, the employer must have a reasonable and good faith belief that giving the notice would have precluded the employer from obtaining the needed capital or business. (*See Section* 1402.5(a)(3).) Again, the information and records submitted indicate that at the time notice was required, December 22, 2008, Insync was not seeking capital or business within the meaning of Section 1402.5(a)(1) or the similar federal exception. Rather, at such time, Insync was seeking a buyer.

Even if seeking a buyer constituted "seeking capital or business" within Section 1402.5(a)(1), and the overwhelming legal authority is clear that it is not, the information and documents presented do not sufficiently establish that providing notice would have precluded Insync from securing a purchaser. In support of the contention that this element is met in this case, Macias states in his declaration that, *he believed*, had Insync provided timely notice as required, it would have resulted in the loss of some of Insync's sales employees, that customers would likely have taken their business elsewhere, and it would have made likely investors and purchasers unwilling to take the risk of investing in the company. (*See* Macias Declaration, ¶ 13 (emphasis added).) Murphy offered similar assertions explaining that, at the time notices would have been required, "[Insync's] day-to-day expenses (including payroll) were being funded by Wells Fargo, but only because Wells Fargo thought there was a reasonable chance Insync could be sold for some amount sufficient to cover Insync's debt." (*See* Murphy Declaration, ¶ 12.) Neither Macias nor Murphy provides any objective evidence, however, in support of these assertions and beliefs. Accordingly, such information and documents submitted do not support a determination that Insync had a reasonable and good faith belief that giving notice would have precluded Insync from obtaining needed capital. (*See Childress v. Darby Lumber, Inc.* (9th Cir. 2004) 357 F.3d 1000, 1009 ["appellants provided no evidence that they reasonably and in good faith believed that giving the sixty-day notice to their employees during the negotiations with U.S. Bank would have precluded them from obtaining the credit from the bank."]; *see also United Paperworkers*, *supra*, 901 F. Supp. at 441 ["there is not a scintilla of objective proof in the record to demonstrate that this

belief [that advising the employees of the company's financial condition would destroy the company's ability to market its business] was held reasonably and in good faith."].)

The federal regulations support this conclusion. 20 C.F.R. § 639.9(a)(4) provides in part:

> The employer must be able to objectively demonstrate that it reasonably thought that a potential customer or source of financing would have been unwilling to provide the new business or capital if notice were given, that is, if the employees, customers, or the public were aware that the facility, operating unit, or site might have to close. *This condition may be satisfied if the employer can show that the financing or business source would not choose to do business with a troubled company or with a company whose workforce would be looking for other jobs.*" (emphasis added.)

Here, no objective evidence is presented showing that the putative financing or business sources sought by Insync would not continue to do business with it had Insync provided timely notice to its workers.

In sum, the information and documents presented do not sufficiently establish that Insync had a reasonable and good faith belief, as required under Section 1402.5(a)(3), that providing notice would have precluded it from obtaining capital or business.

III. CONCLUSION

For the foregoing reasons and under the facts presented here, Insync has not met the requirements under Labor Code § 1402.5. It is therefore not entitled to an exemption from the employee notice requirements contained in Section 1401.

Dated: January 4, 2010

John C. Duncan, Director
Department of Industrial Relations